



**NASAA**

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

10 G Street N.E., Suite 710  
Washington, DC 20002  
202/737-0900  
Telecopier: 202/783-3571  
E-mail: [info@nasaa.org](mailto:info@nasaa.org)  
Web Address: <http://www.nasaa.org>

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**TESTIMONY OF BRADLEY W. SKOLNIK**

Indiana Securities Commissioner  
Chairman, Enforcement Section  
North American Securities Administrators Association, Inc.

Before the

House Financial Services Oversight and Investigations Subcommittee

U.S. House of Representatives

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Chairwoman Kelly, Ranking Member Gutierrez and Members of the Subcommittee,

I'm Brad Skolnik, Indiana Securities Commissioner and Chairman of the Enforcement Section for the North American Securities Administrators Association, Inc. (NASAA).<sup>1</sup> I commend you for holding this hearing, and thank you for the opportunity to appear today to present our views on how Congress can help investors avoid fraud.

The securities administrator in your state is responsible for the licensing of investment professionals and securities offerings, investor education and, most importantly, the enforcement of state and federal securities laws. We have been called the "local cops on the beat," and I believe that is an accurate characterization.

Today your focus is on the case of Frank Gruttadauria: He was a clever insider who avoided the detection of his firm's supervisors for many years. Sadly, it sometimes takes an incident like this to shed light on a potential problem and lead to consideration of changes and reforms. My testimony will focus on two questions: What should Congress, the industry, and securities regulators do to prevent another Gruttadauria from cheating investors out of their money? What steps should investors take to better protect themselves from these criminals?

I believe our securities laws and regulations are fundamentally sound. One lesson from this case might be that compliance departments need to toughen their enforcement of the laws already on the books by strengthening their oversight activities. In my view, compliance departments should have reasonably designed standards and systems in place to prevent and detect fraud. For example, it is important that firms implement an effective centralized compliance system to approve the opening of accounts, and monitor associated name and address changes.

In addition, I encourage brokerage firms of a reasonable size to provide on-line access to their customers' account statements. Investors will then be able to check their mailed account statements against the information provided directly by the firm's website, which is not subject to manipulation by a crooked broker. This service should be provided in an equitable manner to all clients, including those with moderate investments.

Another useful tool would be more resources for regulators to do their jobs. I applaud recent Congressional action to raise the SEC budget by more than half to \$776 million. This is a good start and includes pay parity to allow the Commission to retain top staff and meet its charges to protect investors and maintain the integrity of our securities markets. We need to make sure that state and federal regulators have the resources they need to conduct regular and extensive exams and audits.

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

There is another way to fight these criminal fraudsters. We need to change our collective mind-set about white-collar crime. Make no mistake: Securities fraud is not a victimless crime. It destroys lives just as surely as street crime does.

Securities regulators must work with prosecutors to obtain criminal convictions. The prospect of serious jail time is the only way to deter these calculating, cold-blooded, recidivist criminals. Anything less is viewed as just a cost of doing business.

Another reason starch collar criminals aren't getting the punishment they deserve: securities cases are complex, costly and time-consuming. The truth is some prosecutors shy away from them because the subject is complicated and difficult to understand, and explain to a jury. But from my perspective as a state securities regulator, white-collar criminals who commit securities fraud deserve prison time just like thieves, muggers and murderers.

Think about it: Someone steals your car...they go to prison. A con artist steals the money your parents saved for retirement and just gets fined. That's not right.

As a stockbroker, first at S.G. Cowen and then at Lehman Brothers, Frank Gruttadauria allegedly diverted his clients account statements to a post office box without their authorization. He then misappropriated client funds and issued fictitious account statements to cover up his misdeeds and make it appear the investments were secure.

Make no mistake about it. Frank Gruttadauria stands accused of being an unscrupulous scam artist and his alleged criminal activities will be addressed in a court of law. But, sadly to say, this is not an isolated case. While Gruttadauria has attracted national attention because of the magnitude of his crime, this case is in many ways all too typical. As a state securities commissioner, I have encountered many fraudsters who have swindled hardworking Americans out of their life savings.

Over the past few years in my home state of Indiana, we have encountered at least two incidents where stockbrokers employed some of the same tactics, such as the issuance of fictitious account statements to plunder their clients. These two cases bear a disturbing similarity to the Gruttadauria case. Like Gruttadauria, the two Indiana brokers had no history of disciplinary problems or complaints and were well regarded in their local communities. There was next to nothing that would have tipped off investigators or customers about their criminal proclivities. The only real difference that matters today is that, unlike Gruttadauria, who is in custody and awaiting trial, these two Indiana brokers who stole from their clients are still at-large and wanted by the law.

### **Mary Louise Sanders**

In late December 2000, Mary Louise Sanders, the president of Spectrum Investment Services, Inc., a 40-person Mishawaka, Indiana-based broker-dealer, told her employees that she was going on a vacation over the holidays. She was supposed to return to the office on January 2, 2001. But she still hasn't appeared.

Shortly after New Year's, it was discovered that Sanders, then a 57-year old grandmother, disappeared with more than \$2 million dollars in client funds that were supposed to be used for the purchase of mainstream investment products such as mutual funds. While Sanders purported to sell rather low-risk mutual funds, it was discovered that she never invested the funds as promised; instead, she misappropriated the client funds and issued fictitious account statements to investors that looked legitimate to the untrained eye. The scheme was uncovered when just after New Years in January 2001, one of Sanders' clients came to the office to liquidate some of his investments. When one of Sanders' co-workers sought to assist the investor in her absence, it was learned that the investment accounts did not even exist.

The Sanders case is remarkable in the sense that she is everything a con-artist is not supposed to be: Mary Louise Sanders was a devoted grandmother and refined businesswoman who was well respected in the community.

Sanders is still missing and is a fugitive. Fortunately, many of the losses sustained by investors have been covered by the Securities Investor Protection Corporation (SIPC). The Indiana Securities Division moved in January 2001 to summarily suspend the licenses of Spectrum Investment Services, Inc. and its president Mary Louise Sanders. Federal authorities are actively attempting to locate her on an outstanding arrest warrant for mail fraud.

### **Phillip Ferguson**

Phillip Ferguson is a stockbroker and financial consultant who operated a financial services business in Marion, Indiana since the mid 1980's.

In the summer of 2000, it was discovered that Ferguson misappropriated millions of dollars of client funds that he purported to invest in a variety of different investment products, including certificates of deposit, bonds, mutual funds, variable annuities and a commodity pool.

Ferguson disappeared after a routine audit of an introducing broker in the summer of 2000 revealed suspicious activity in an account he controlled. In July 2000, the CFTC filed a civil suit in federal district court in Fort Wayne, IN. It was alleged that Ferguson was engaged in the unauthorized and unregistered operation of a commodity pool.

As an example of regulatory cooperation, the CFTC alerted the Indiana Securities Division that Ferguson was also apparently involved in securities activities and that the Division may want to follow up with its own investigation. The Securities Division investigation revealed that while Ferguson sold what he represented to be a variety of rather low-risk investment products, including bonds, mutual funds and variable annuities, to over 300 mostly elderly investors, he never invested the money. Rather than investing the monies as represented, Ferguson misappropriated the funds for his own use.

It is estimated that investors may have lost as much as \$30 to 50 million in connection with the fictitious investments sold by Ferguson. It is one of the largest homegrown, locally based frauds in Indiana history.

Ferguson deceived investors by creating fictitious instruments, including phony bonds and variable annuities, as well as issuing bogus account statements.

As with the Sanders case, the Ferguson matter lacked many of the classic signals of securities fraud: high-pressure sales tactics, promises of sky-high returns and Ferguson had no history of complaints or disciplinary actions. He operated a massive criminal enterprise by selling investments that didn't exist. By issuing bogus account statements and other documents, he was able to cover up his scheme. Unfortunately, most of the warning signs that might have alerted investors to fraud were not present.

An intensive, month long Securities Division investigation resulted in the filing in September 2000 of a 90-count criminal complaint by the Grant County, Indiana prosecuting attorney against Ferguson. He has also been charged with unlawful flight to avoid prosecution by federal officials in the Northern District of Indiana. Ferguson is still missing and is among the FBI's most wanted fugitives.

## **Recommendations**

How can we better protect investors from being victimized by the next Frank Gruttadauria, Mary Louise Sanders or Phillip Ferguson. We need to realize that no matter what we do there will always be clever con artists. That's why stiff penalties and long prison sentences are so important. While they sadly can't put money back in investors' pockets, they are ultimately the strongest deterrent to investment fraud.

In addition, NASAA does have some tips for how investors can better protect themselves from sophisticated scams.

1. Periodically check mailed account statements against online account statements from the firm's Web site, or against account information you obtain by calling the firm's headquarters.
2. You've all heard the saying, "Don't put all your eggs in one basket." Well, that applies here, too. Don't put all your investments with one broker. Spread your investments among two or three firms.
3. Contact your state securities regulator to check out a broker before doing business with them. We can tell you if the company or individuals offering investments or advice are licensed or have any disciplinary history. Our website, [www.nasaa.org](http://www.nasaa.org), provides contact for each state. Just click the "find regulator" link on the left side of our homepage.

4. Use common sense. If your written statements show you are making lots of money at a time when the stock market is in decline, you should double-check your accounts with the firm's compliance office.
5. With the advent of desktop publishing, it is not difficult to create bogus account statements. Investors should carefully check the spelling of certain offerings, names, etc. because typos can appear on falsified statements. Investors should also compare information with that found from independent sources such as newspapers and the Internet, and follow-up on discrepancies.
6. Many investment professionals use either custodians or clearing brokers to hold their clients' funds and securities. Investors should periodically compare statements received from their broker with these independent third-parties for confirmation and accuracy.
7. Investors should make sure their account statements are issued by the brokerage firm or mutual fund complex and not from some other business name (that sounds legitimate) used by the investment professional.

## **Conclusion**

One component of the fight against fraud is investor education. Many state securities agencies have established an investor education department in their divisions. In 1999, NASAA created a section committee that is devoted to investor education to reflect its heightened importance to our members and their education efforts. Through NASAA, members have issued investor alerts and press releases to warn about investment scams; held town meetings and investor education seminars; and visited high schools to teach students about personal finance, our capital markets, investment choices and fraud.

I applaud you for holding these hearings in an effort to shed light on the criminal abuses in the securities markets. The problems in this area are serious and systemic, but can be successfully addressed if securities regulators and policy makers work together on solutions.

We've become a nation of investors. Over half of American households are invested in stocks, bonds, mutual funds and money markets. Because of this, there are few issues more urgent than stopping the securities frauds that cost investors billions per year.

I pledge the support of the entire NASAA membership to work with you and provide any additional information or assistance you may need. Thank you.